



Consolidated Financial Statements of

PURE ENERGY SERVICES LTD.

For the years ended December 31, 2005 and 2004



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AUDITORS' REPORT

We have audited the consolidated balance sheets of Pure Energy Services Ltd. as at December 31, 2005 and 2004 and the consolidated statements of operations and retained earnings and cash flows for each of the years in the two year period ended December 31, 2005. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2005 and 2004 and the results of its operations and its cash flows for each of the years in the two year period ended December 31, 2005 in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants

Calgary, Canada
March 6, 2006



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PURE ENERGY SERVICES LTD.

Consolidated Balance Sheets

As at December 31, 2005 and 2004

	2005	2004
Assets		
Current assets		
Cash	\$ 1,699,135	\$ —
Accounts receivable	30,563,609	12,577,295
Marketable securities	—	53,143
Income taxes recoverable	297,162	—
Inventory	485,832	324,466
Deposits and prepaid expenses	780,627	3,559,631
	33,826,365	16,514,535
Property, plant and equipment (note 4)	86,596,119	48,128,380
Intangible assets, net of accumulated amortization of \$81,740	1,062,584	—
Deferred financing costs (note 5)	419,541	—
Goodwill	1,230,381	—
	\$123,134,990	\$ 64,642,915
Liabilities and Shareholders' Equity		
Current liabilities		
Operating loan (note 6)	\$ —	\$ 5,743,993
Accounts payable and accrued liabilities	13,266,450	9,119,465
Income taxes payable	—	415,989
Demand loans (note 7)	—	30,973,168
Current portion of long term debt	688,294	—
	13,954,744	46,252,615
Long term debt (note 8)	25,609,157	—
Future income taxes (note 9)	8,079,597	2,601,985
	33,688,754	2,601,985
Shareholders' equity		
Share capital (note 10)	58,554,122	10,026,387
Contributed surplus (note 10(d))	427,378	10,104
Retained earnings	16,509,992	5,751,824
	75,491,492	15,788,315
Subsequent events (note 18)		
	\$123,134,990	\$ 64,642,915

See accompanying notes to consolidated financial statements.

Approved by the Board

Signed "J. Kevin Delaney" _____ Director

Signed "J. C. Smith" _____ Director

PURE ENERGY SERVICES LTD.

Consolidated Statements of Operations and Retained Earnings

For the years ended December 31,

	2005	2004
Revenue	\$ 100,493,109	\$ 47,107,075
Expenses		
Operating	65,594,769	32,971,722
Selling, general and administrative	11,630,162	5,291,568
Depreciation and amortization	5,685,523	3,567,134
Interest	1,432,384	843,457
Foreign exchange loss	188,093	—
Other income (expense)	(680,573)	116,023
	83,850,358	42,789,904
Income before income taxes	16,642,751	4,317,171
Income taxes (note 9)		
Current	(436,755)	612,639
Future	6,262,599	1,246,985
	5,825,844	1,859,624
Net earnings	10,816,907	2,457,547
Retained earnings, beginning of year	5,751,824	3,673,490
Premium on redemption of shares	(58,739)	(379,213)
Retained earnings, end of year	\$ 16,509,992	\$ 5,751,824
Earnings per share (note 11)		
Basic	\$ 0.99	\$ 0.36
Diluted	\$ 0.97	\$ 0.36

See accompanying notes to consolidated financial statements.

PURE ENERGY SERVICES LTD.

Consolidated Statements of Cash Flows

For the years ended December 31,

	2005	2004
Cash provided by (used in):		
Operations		
Net earnings	\$ 10,816,907	\$ 2,457,547
Items not affecting cash:		
Depreciation and amortization	5,685,523	3,567,134
Future income tax expenses	6,262,599	1,246,985
Stock based compensation expenses	422,885	10,104
Loss (gain) on sale of property, plant and equipment	(574,827)	116,023
Gain on sale of marketable securities	(105,746)	—
Unrealized foreign exchange loss	143,383	—
	22,650,724	7,397,793
Change in non-cash working capital (note 17)	(14,761,260)	799,584
	7,889,464	8,197,377
Investing		
Purchase of property, plant and equipment	(43,804,889)	(19,758,753)
Proceeds from the sale of property, plant and equipment	2,837,839	—
Proceeds from the sale of marketable securities	158,889	(50)
Business acquisitions (note 3)	(1,947,824)	(8,289,248)
Change in non-cash working capital on investing activities	2,633,559	(4,275,931)
	(40,122,426)	(32,323,982)
Financing		
Operating loan	(5,743,993)	3,046,561
Demand loans	(30,973,168)	21,826,167
Issuance of long term debt	27,297,451	—
Repayment of long term debt	(1,000,000)	—
Redemption of shares	(177,675)	(482,250)
Issuance of share capital, net	45,997,672	1,080,558
Return of paid up capital	(1,468,190)	(1,344,431)
	33,932,097	24,126,605
Increase in cash	1,699,135	—
Cash, beginning of year	—	—
Cash, end of year	\$ 1,699,135	\$ —

Supplemental information (note 17)

See accompanying notes to consolidated financial statements.

PURE ENERGY SERVICES LTD.

Notes to the Consolidated Financial Statements

For the years ended December 31, 2005 and 2004

1. Nature of business

Pure Energy Services Ltd. (the "Corporation") is incorporated under the Business Corporations Act (Alberta) and provides completion and drilling related oilfield services to oil and gas exploration and development entities in the western Canadian Sedimentary Basin in Canada and the U.S. Rocky Mountain region.

2. Significant accounting policies

The following is a summary of significant accounting policies used in the preparation of these consolidated financial statements:

(a) Basis of presentation

These consolidated financial statements include the accounts of the Corporation and its subsidiaries and partnership, all of which are wholly-owned.

(b) Inventory

Inventory consists of parts and operating supplies which are stated at the lower of cost, on a specifically identified basis, and net realizable value.

(c) Marketable securities

Marketable securities are carried at the lower of cost and market value. The securities were sold during the year for proceeds of \$158,889. (Market value at December 31, 2004 - \$81,743).

(d) Deposits

The Corporation has certain refundable deposits as at December 31, 2005 in the amount of \$nil (December 31, 2004 - \$3,216,648) for equipment to be constructed. Upon commencement of construction, the deposits are reclassified to property, plant and equipment.

(e) Deferred financing costs

All costs incurred in connection with the raising of equity financing are capitalized until such time that the financing is completed or abandoned. When an equity financing is completed, the associated expenditures will be charged to share capital as a cost of issuing shares. If an equity financing is abandoned, the associated costs will be charged to operations.

PURE ENERGY SERVICES LTD.

Notes to the Consolidated Financial Statements, page 2

For the years ended December 31, 2005 and 2004

2. Significant accounting policies (continued)

(f) Property, plant and equipment

Property, plant and equipment is stated at cost less accumulated depreciation. Depreciation is calculated after providing for estimated salvage values at a rate which is expected to depreciate the cost of the asset over its estimated useful life. The methods and rates applied are:

Assets	Method	Rate
Buildings	declining balance	6 %
Drilling rig equipment	unit of production	based on 3,650 days
Drilling rental equipment	straight-line	10%
Completion services equipment	straight-line	10% to 14%
Furniture and fixtures	declining balance	20% to 30%
Automotive equipment	declining balance	30%
Leasehold improvements	straight-line	20%

Completion services equipment and drilling services equipment is depreciated to an expected residual value of 20%.

Management bases the estimate of the useful life and salvage value of property, plant and equipment on expected utilization, technological change and effectiveness of maintenance programs. Although management believes the estimated useful lives of the Corporation's property, plant and equipment are reasonable, it is possible that changes in estimates could occur which may affect the expected useful lives.

(g) Intangible assets

Intangible assets are recorded at cost. Amortization is provided using the methods and rates indicated below based on the assets' estimated useful lives as follows:

Assets	Method	Rate
Customer relationships	straight-line	10 years
Non-competition agreement	straight-line	3 years
Trade name	straight-line	10 years

PURE ENERGY SERVICES LTD.

Notes to the Consolidated Financial Statements, page 3

For the years ended December 31, 2005 and 2004

2. Significant accounting policies (continued)

(h) Goodwill

Goodwill represents the excess of the purchase price for business acquisitions over the fair value of the net assets acquired. Goodwill is allocated as of the date of the business acquisition to the Corporation's reporting units that are expected to benefit from the synergies of the business combination. Goodwill is not amortized, but is tested for impairment at least annually.

The impairment test is carried out in two steps. In the first step, the carrying amount of the reporting unit is compared with its fair value. When the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not to be impaired and performance of the second step of the impairment test is unnecessary. The second step compares the implied fair value of the reporting unit's goodwill with its carrying amount to measure the amount of the impairment loss, if any. If the carrying amount of goodwill exceeds the implied fair value of goodwill, an impairment loss is recognized in an amount equal to the excess.

(i) Income taxes

Income taxes are accounted for under the asset and liability method of accounting for income taxes. Under the asset and liability method, future tax assets and liabilities are recognized for the future income tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future income tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply when the asset is realized or the liability settled. The effect on future income tax assets and liabilities of a change in tax rates is recognized in income in the period that substantive enactment or actual enactment occurs. The computation of the provision for income taxes involves tax interpretations, regulations and legislation that are continually changing.

(j) Stock-based purchase plan

The Corporation has instituted a stock based purchase plan to allow and encourage employees and other eligible participants to acquire shares of the Corporation. The plan is administered by the Board of Directors who determine who will be allowed to participate, the number of common shares they will be offered, the price of the common shares, and the time in which the offer will remain open.

PURE ENERGY SERVICES LTD.

Notes to the Consolidated Financial Statements, page 4

For the years ended December 31, 2005 and 2004

2. Significant accounting policies (continued)

(k) Stock-based compensation plan

The Corporation has a stock-based compensation plan as described in Note 10(c). Options are granted at the fair value of the Corporation's common shares as determined by the Board of Directors on the grant date of the options. The Corporation accounts for stock options using the Black-Scholes option pricing model. Under this method, all stock options issued under the stock-based compensation plan generate an expense to the Corporation based on the expected future benefit to the holder as determined by the difference between the exercise price and current share price of the share as impacted by the vesting period of the options, the potential price volatility, the length of the option period and other valuation factors. The expense is recognized over the vesting period of the options. When stock options are exercised, the proceeds together with the amount recorded in contributed surplus are recorded in share capital.

(l) Revenue recognition

The Corporation recognizes revenue at the time the product is provided or service is performed on a daily, hourly or job basis. Revenue is not recognized before there is persuasive evidence that an arrangement exists, delivery has occurred or the service has been provided, the rate is fixed and determinable, and the collectibility of outstanding amounts is considered probable. The Corporation considers persuasive evidence to exist when a formal contract is signed or customer acceptance is obtained. Contract terms do not include a provision for post-service obligations.

(m) Long-lived assets

Long-lived assets, which include property, plant and equipment and intangible assets, are tested for impairment annually, or more frequently as circumstances require. Indications of impairment include items such as an ongoing lack of profitability and significant changes in technology. When an indication of impairment is present, the Corporation tests for impairment by comparing the carrying value of the asset to its net recoverable amount. If the carrying amount is greater than the net recoverable amount, the asset is written down to its estimated fair value. There were no indications of impairment.

(n) Foreign currency translation

The Corporation's United States subsidiary is considered financially and operationally dependent on the Corporation and is therefore classified as an integrated foreign operation for which the temporal method is used to translate its financial statements. Under this method, monetary assets and liabilities are translated at the rate of exchange in effect at the balance sheet date, non-monetary items are translated at historical exchange rates and revenue and expenses are translated at the average exchange rate for the year. Exchange gains or losses are included in the determination of net income.

PURE ENERGY SERVICES LTD.

Notes to the Consolidated Financial Statements, page 5

For the years ended December 31, 2005 and 2004

2. Significant accounting policies (continued)

(o) Earnings per share

Basic earnings per share is calculated using the weighted average number of common shares outstanding during the year. Under the treasury stock method, diluted net earnings per share is calculated based on the weighted average number of shares issued and outstanding during the year, adjusted by the total of the additional common shares that would have been issued assuming exercise of all stock options with exercise prices at or below the average market price for the year, offset by the reduction in common shares that would be purchased with the exercise proceeds.

(p) Use of estimates

The financial statements are prepared in accordance with Canadian generally accepted accounting principles (GAAP). Management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reported period. Actual results could differ from those estimates.

(q) Comparative figures

Certain comparative figures have been reclassified to conform to the presentation adopted in the current year.

3. Business acquisitions

- (a) On November 1, 2005, the Corporation acquired all of the issued and outstanding shares of Motorworks Drilling Solutions Inc. The Corporation paid \$1,333,344, consisting of 111,112 common shares of the Corporation, for the acquisition. The results of operations have been included in the consolidated financial statements from the date of acquisition. The acquisition has been accounted for using the purchase method whereby the purchase price is allocated to the net assets acquired based on their fair values.
- (b) On May 1, 2005, the Corporation acquired all of the business assets of Ross Wireline Services Ltd. The Corporation paid consideration of \$3,202,505, consisting of cash and the issuance of 130,000 common shares of the Corporation, for the acquisition. The results of operations have been included in the consolidated financial statements from the date of acquisition. The acquisition has been accounted for using the purchase method whereby the purchase price is allocated to the net assets acquired based on their fair values.

PURE ENERGY SERVICES LTD.

Notes to the Consolidated Financial Statements, page 6

For the years ended December 31, 2005 and 2004

3. Business acquisitions (continued)

The purchase price of the above acquisitions has been allocated as follows:

	Motorworks Drilling Solutions Inc.	Ross Wireline Services Ltd.	Total
Net assets acquired			
Non-cash working capital (deficiency)	\$ (84,247)	\$ 2,505	\$ (81,742)
Drilling equipment	674,653	–	674,653
Wireline equipment	–	1,700,000	1,700,000
Intangible assets	390,000	754,324	1,144,324
Goodwill	484,705	745,676	1,230,381
Future income tax liability	(216,448)	–	(216,448)
	1,248,663	3,202,505	4,451,168
Cash	84,681	–	84,681
	\$ 1,333,344	\$ 3,202,505	\$ 4,535,849
Consideration given			
Cash	\$ –	\$ 2,032,505	\$ 2,032,505
Common shares issued	1,333,344	1,170,000	2,503,344
	\$ 1,333,344	\$ 3,202,505	\$ 4,535,849

- (c) On December 29, 2004, the Corporation acquired all of the business assets of Quintera Drilling Ltd. The Corporation paid consideration of \$13,514,248 for the acquisition. The results of operations have been included in the consolidated financial statements from the date of acquisition. The acquisition has been accounted for using the purchase method whereby the purchase price is allocated to the net assets acquired based on their fair values as follows:

Net assets acquired	
Drilling equipment	\$13,349,999
Land	164,249
	\$13,514,248
Consideration	
Cash	\$ 8,289,248
388,889 common shares issued	3,500,000
Accounts payable to Quintera Drilling Ltd.	1,725,000
	\$13,514,248

PURE ENERGY SERVICES LTD.

Notes to the Consolidated Financial Statements, page 7

For the years ended December 31, 2005 and 2004

4. Property, plant and equipment

2005	Cost	Accumulated depreciation	Net book value
Land	\$ 952,522	\$ —	\$ 952,522
Buildings	5,733,845	529,821	5,204,024
Drilling Services equipment	21,855,496	613,777	21,241,719
Completion Services equipment	53,105,797	8,526,045	44,579,752
Furniture and fixtures	3,936,473	1,404,786	2,531,687
Automotive	2,680,109	1,198,579	1,481,530
Assets under construction	10,549,432	—	10,549,432
Leasehold improvements	82,145	26,692	55,453
	\$ 98,895,819	\$12,299,700	\$86,596,119

2004	Cost	Accumulated depreciation	Net book value
Land	\$ 765,111	\$ —	\$ 765,111
Buildings	5,150,535	287,279	4,863,256
Drilling Services equipment	13,248,666	—	13,248,666
Completion Services equipment	31,473,652	5,168,179	26,305,473
Furniture and fixtures	2,298,078	779,590	1,518,488
Automotive	2,076,948	673,352	1,403,596
Leasehold improvements	34,774	10,984	23,790
	\$ 55,047,764	\$ 6,919,384	\$48,128,380

As at December 31, 2005, the Corporation has further obligations totaling approximately \$22.7 million relating to the construction of fixed assets.

Subsequent to December 31, 2005, the Corporation has committed to spend an additional \$2.6 million relating to the construction of property, plant, and equipment.

5. Deferred financing costs

Deferred financing costs consist of legal and accounting expenses relating to the Corporation's prospectus filing and initial public offering of shares. The initial public offering was completed subsequent to the year end and the associated costs have been charged to share capital, net of the related future tax benefit.

PURE ENERGY SERVICES LTD.

Notes to the Consolidated Financial Statements, page 8

For the years ended December 31, 2005 and 2004

6. Operating loan

The Corporation has access to a \$20,000,000 revolving demand operating loan. Advances are available at either the bank's prime rate plus 0.5% or subject to availability at the bank's Bankers' Acceptance rate plus 1.75%, or in combination. The loan is secured by a general security agreement and mortgages covering all of the Corporation's property. At December 31, 2005, no amounts were drawn on the operating facility (December 31, 2004 - \$5,743,993).

7. Demand loans

	2005	2004
Demand capital loan bearing interest at bank prime rate plus 1% per annum, repayable over 60 months and secured by a general security agreement covering all Corporation properties, an assignment of risk insurance and other corporate security	\$ —	\$ 8,859,064
Demand non-revolving capital loan bearing interest at bank prime rate plus 1% per annum, repayable over 60 months, initially fundable to \$10,000,000, and secured by a general security agreement covering all Corporation properties, an assignment of risk insurance and other corporate security	—	8,289,248
Demand capital loan bearing interest at bank prime rate plus 1% per annum, repayable in monthly installments of \$115,695 plus interest and secured by a general security agreement covering all Corporation properties, an assignment of risk insurance and other corporate security	—	5,900,412
Demand capital loan bearing interest at bank prime rate plus 1% per annum, repayable over 60 months, initially funded to \$7,655,000, and secured by a general security agreement covering all Corporation properties, an assignment of risk insurance and other corporate security	—	3,854,283
Demand construction loan bearing interest at bank prime rate plus 1% per annum, repayable in monthly installments of \$20,833 plus interest and secured by a collateral mortgage on the land and buildings, an assignment of risk insurance and other corporate security	—	2,312,500
Demand construction loan bearing interest at bank prime rate plus 1% per annum, repayable over 120 months secured by a collateral mortgage on the land and buildings, an assignment of risk insurance and other corporate security	—	1,757,661
	\$ —	\$30,973,168

PURE ENERGY SERVICES LTD.

Notes to the Consolidated Financial Statements, page 9

For the years ended December 31, 2005 and 2004

8. Long term debt

The Corporation has a \$50,000,000 extendible revolving term loan facility and a \$5,000,000 non-revolving term loan facility in replacement of its existing demand loan facilities. Advances under the extendible revolving term loan facility are available at one of the bank's prime rate plus 0.5%, the bank's Bankers' Acceptance rate plus 1.75% or the bank's fixed rate, subject to availability or in combination. The facility is extendible annually at the bank's option. The current extension date of this facility is November 30, 2006. Should this facility not be extended, outstanding amounts will be transferred to a four-year term facility repayable monthly. This facility is subject to a maximum availability of 60% of the net book value of the Corporation's property, plant and equipment until the earlier of the Corporation's initial public offering or April 30, 2006 and 50% thereafter.

The \$5,000,000 non-revolving term loan facility has been advanced at the bank's prime rate plus 0.75% and is repayable monthly over fifteen years.

	2005	2004
Extendible revolving term loan facility	\$ 21,297,451	\$ —
Non-revolving term loan facility	5,000,000	—
Less current portion	(688,294)	—
	\$ 25,609,157	\$ —

During fiscal 2005, the Corporation incurred interest on long-term debt of \$98,916 (2004 - \$nil).

Required principal repayments for the long term debt are as follows:

Year ended December 31,	
2006	\$ 688,294
2007	4,592,826
2008	4,592,826
2009	4,592,826
2010	4,592,826
Thereafter	7,237,853

PURE ENERGY SERVICES LTD.

Notes to the Consolidated Financial Statements, page 10

For the years ended December 31, 2005 and 2004

9. Income taxes

Income tax expense differs from the amount that would be computed by applying the federal and provincial statutory tax rates of 33.8% (2004 - 34.1%) to income before income taxes. The reasons for the differences and related income tax effects are as follows:

Year ended December 31,	2005	2004
Computed expected tax expense	\$ 5,628,578	\$ 1,472,155
Non-deductible expenses	415,243	262,097
Stock-based compensation	143,020	—
Non-taxable portion of capital gains	(83,155)	—
Increase (reduction) of future tax balances due to substantively enacted income tax rate changes	(34,637)	130,693
Other	(243,205)	(5,321)
	<u>\$ 5,825,844</u>	<u>\$ 1,859,624</u>

The income tax effect of temporary differences that give rise to significant portions of the future tax assets and liabilities at December 31, 2005 and 2004 are presented below:

	2005	2004
Future income tax liabilities		
Property, plant and equipment	\$ 5,677,832	\$ 2,743,523
Intangible assets	212,840	—
Operations of a partnership with a different tax year	6,025,603	—
Future income tax assets		
Tax losses carried forward	(1,258,700)	(138,403)
Deferred expenditures	(1,745,759)	—
Share issue costs	(832,219)	(3,135)
	<u>(3,836,678)</u>	<u>(141,538)</u>
	<u>\$ 8,079,597</u>	<u>\$ 2,601,985</u>

At December 31, 2005, the Corporation had non-capital losses that can be used to reduce future taxable income in Canada of \$3,721,761 (December 31, 2004 - \$nil) and the United States of \$nil (December 31, 2004 - \$406,000).

PURE ENERGY SERVICES LTD.

Notes to the Consolidated Financial Statements, page 11

For the years ended December 31, 2005 and 2004

10. Share capital

(a) Authorized:

An unlimited number of common shares

An unlimited number of preferred shares issuable in series with the designation, rights, privileges, restrictions and conditions of each series to be fixed by the Board of Directors

(b) Common shares issued:

	Number of Shares	Amount
Balance, December 31, 2003	6,609,434	\$ 6,893,297
Issued for cash	337,559	1,087,555
Issued on business acquisition (note 3)	388,889	3,500,000
Return of paid up capital	—	(1,344,431)
Shares issued to an officer under a share purchase loan	40,000	130,000
Redeemed during the year	(93,500)	(103,037)
Share issue costs, net of future income tax benefit of \$nil	—	(6,997)
Share purchase loans	—	(130,000)
Balance, December 31, 2004	7,282,382	10,026,387
Issued for cash	5,174,264	49,317,518
Issued on business acquisitions - (Note 3)	241,112	2,503,344
Issued on purchase of property, plant, and equipment	12,916	154,992
Issued on the exercise of stock options	6,667	40,002
Return of paid up capital	—	(1,468,190)
Redeemed during the year	(28,075)	(118,936)
Share issue costs, net of future income tax benefits of \$1,033,701	—	(2,036,606)
Contributed surplus relating to options exercised	—	5,611
Share purchase loans paid	—	130,000
Balance, December 31, 2005	12,689,266	\$58,554,122

- (i) On January 31, 2005 the Corporation paid a return of paid up capital of \$1,468,190 to its shareholders (May 25, 2004 - \$1,344,431).
- (ii) During 2005, a share purchase loan to an officer of the Corporation in the amount of \$130,000 was repaid in full.

PURE ENERGY SERVICES LTD.

Notes to the Consolidated Financial Statements, page 12

For the years ended December 31, 2005 and 2004

10. Share capital (continued)

(c) Stock options

Options to purchase common shares may be granted by the Board of Directors to directors, officers, employees, and service providers of the Corporation. With the exception of one option grant, the options vest one third on each of the first, second, and third anniversary dates of the grant date on a cumulative basis and have a maximum term of ten years.

The Corporation calculates the fair value of its options using the Black-Scholes option pricing model. While the Corporation was private, it determined share price volatility to be nil. The following weighted average assumptions were used to determine the fair value of options on date of grant:

Risk free interest rate	3.50%
Expected life	5 years
Maximum life	10 years
Vesting period	3 years
Expected dividend	\$nil per share
Expected share price volatility	0%
Pre-vesting employee exit rate	6.44%

The average fair value of options issued in 2005 was determined to be \$1.54 per option (December 31, 2004 - \$0.97) using the Black-Scholes option pricing model. The compensation cost to the Corporation for the years ending December 31, 2005 and 2004 was \$422,885 and \$10,104, respectively.

The Corporation has reserved 1,268,927 common shares as at December 31, 2005 (December 31, 2004 – 364,119) for issuance under a stock option plan for officers, directors, employees, and service providers of the Corporation. The maximum number of shares reserved for issuance under the stock option plan or any other stock option or share purchase plan or other securities based compensation arrangements of the Corporation shall not exceed 10% (December 31, 2004 – 5%) of the total number of outstanding common shares.

PURE ENERGY SERVICES LTD.

Notes to the Consolidated Financial Statements, page 13

For the years ended December 31, 2005 and 2004

10. Share capital (continued)

(c) Stock options (continued)

A summary of the status of the Corporation's stock option plan as of December 31, 2005 and December 31, 2004, and changes during the years then ended is presented below:

	December 31, 2005		December 31, 2004	
	Options	Weighted average exercise price	Options	Weighted average exercise price
Outstanding at the beginning of the year	310,500	\$ 6.00	—	\$ —
Granted	947,125	9.22	310,500	6.00
Exercised	(6,667)	6.00	—	—
Cancelled/Forfeited	(35,333)	7.87	—	—
Outstanding at the end of the year	1,215,625	\$ 8.46	310,500	\$ 6.00
Exercisable at the end of the year	105,062	\$ 6.00	3,800	\$ 6.00

The following table summarizes information about stock options outstanding at December 31, 2005:

Options Outstanding					Options Exercisable		
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Life (years)	Weighted Average Exercise Price		Number Exercisable	Weighted Average Exercise Price	
\$6.00 to \$6.00	290,500	8.9	\$ 6.00		105,062	\$ 6.00	
\$6.00 to \$12.00	925,125	9.6	9.23		—	—	
\$6.00 to \$12.00	1,215,625	9.4	\$ 8.46		105,062	\$ 6.00	

Options to acquire 50,000 common shares at an exercise price of \$nil were granted by the Corporation to an officer in connection with his offer of employment. The Corporation has reserved 50,000 common shares for issuance pursuant to these options. Although these options were not granted pursuant to the stock option plan, they have terms that are generally consistent with options granted under such plan, except that they vest one half on each of the first and second anniversary dates of the grant date on a cumulative basis and have a maximum term of ten years. As at December 31, 2005, the average remaining life of these options was 9.4 years and none of the options were exercisable.

PURE ENERGY SERVICES LTD.

Notes to the Consolidated Financial Statements, page 14

For the years ended December 31, 2005 and 2004

10. Share capital (continued)

(d) Contributed Surplus

Balance, December 31, 2004	\$ 10,104
Stock-based compensation expense	422,885
Reclassified to common shares on exercise of options	(5,611)
Balance, December 31, 2005	\$ 427,378

11. Earnings per share

	2005	2004
Net income available to common shareholders	\$10,816,907	\$ 2,457,547
Weighted average number of common shares	10,910,471	6,761,906
Basic earnings per share	\$0.99	\$0.36
Net income available to common shareholders	\$10,816,907	\$ 2,457,547
Weighted average number of common shares	10,910,471	6,761,906
Dilutive effect of stock options	186,500	1,991
Diluted weighted average number of common shares	11,096,971	6,763,897
Diluted earnings per share	\$0.97	\$0.36

12. Commitments

The Corporation's obligations under various operating leases for office and warehouse facilities, office equipment, computers and automobiles are as follows:

Year ended December 31,	
2006	\$ 2,184,000
2007	1,801,000
2008	981,000
2009	470,000
2010	469,000

PURE ENERGY SERVICES LTD.

Notes to the Consolidated Financial Statements, page 15

For the years ended December 31, 2005 and 2004

13. Contingencies

- (a) The Corporation has guaranteed loans totaling \$317,037 as at December 31, 2005 (December 31, 2004 - \$339,346) in relation to the Financial Assistance Program which assists employees to acquire shares of the Corporation. Grants under the Financial Assistance Program have been terminated.
- (b) The Corporation, through the performance of its services, is sometimes named as a defendant in litigation. The nature of these claims is usually related to personal injury or completed operations. The Corporation maintains a level of insurance coverage deemed appropriate by management and for matters for which insurance coverage can be maintained. The Corporation has no outstanding claims which would have a material adverse effect on the Corporation as a whole.

14. Related party transactions

- (a) During the year ended December 31, 2005, the Corporation incurred and paid legal fees of \$175,000 (year ended December 31, 2004 - \$70,853) to a director. These transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.
- (b) The Corporation has entered into a seven year operating lease with a company controlled by an officer of the Corporation. Monthly lease payments are \$11,000. This transaction is in the normal course of operations and is measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

15. Financial instruments

- (a) Fair value of financial instruments

The carrying values of accounts receivable, deposits and prepaid expenses, operating loan, and accounts payable and accrued liabilities approximate their fair value due to the relatively short period to maturity of the instruments. All operating and demand bank loans with variable interest rates are considered by management to approximate fair value.

- (b) Credit risk

A substantial portion of the accounts receivable are with customers who are dependent upon the oil and gas industry, and are subject to normal industry credit risks. Sales to ten customers for the year ended December 31, 2005 amount to approximately 49% (year ended December 31, 2004 - 46%) of total revenue.

PURE ENERGY SERVICES LTD.

Notes to the Consolidated Financial Statements, page 16

For the years ended December 31, 2005 and 2004

15. Financial instruments (continued)

(c) Interest rate risk

The Corporation manages its exposure to interest rate risk through floating rate borrowings.

(d) Exchange rate risk

The Corporation wholly owns a subsidiary which operates in the United States. The investment in the subsidiary and any funds flowing back and forth between parent and subsidiary for management fees, lease payments or other transactions are subject to the fluctuations of currency exchange.

16. Segmented information

The Corporation operates in two main industry segments which operate in two geographic areas. These segments are Completion Services and Drilling Services and provide the following services to oil and gas exploration and production companies:

- Completion Services provides logging and perforating, production testing, multiline and pressure transient analysis services which are performed on new and producing oil and gas wells;
- Drilling Services provides contract drilling services.

The segmented amounts are as follows:

Year ended December 31, 2005	Completion Services	Drilling Services	Corporate	Total
Revenue	\$ 84,953,670	\$ 15,539,439	\$ –	\$100,493,109
Income / (loss) before income taxes	18,489,158	4,513,765	(6,360,172)	16,642,751
Depreciation and amortization	4,814,034	738,734	132,755	5,685,523
Capital expenditures	32,588,727	10,431,876	939,278	43,959,881
Total assets	87,858,061	29,759,522	5,517,407	123,134,990
Goodwill	745,676	484,705	–	1,230,381

Year ended December 31, 2004	Completion Services	Drilling Services	Corporate	Total
Revenue	\$ 46,983,608	\$ 123,467	\$ –	\$ 47,107,075
Income / (loss) before income taxes	6,919,633	48,913	(2,651,375)	4,317,171
Depreciation and amortization	3,486,803	–	80,331	3,567,134
Capital expenditures	19,537,838	–	220,915	19,758,753
Total assets	49,667,746	13,379,748	1,595,421	64,642,915
Goodwill	–	–	–	–

PURE ENERGY SERVICES LTD.

Notes to the Consolidated Financial Statements, page 17

For the years ended December 31, 2005 and 2004

The Corporation operates in the following geographic locations:

Year Ended December 31, 2005	Canada	United States	Total
Revenue	\$ 87,226,357	\$13,266,752	\$ 100,493,109
Property and equipment	\$ 74,687,133	\$11,908,986	\$ 86,596,119

In fiscal 2004, US operations were insignificant.

17. Supplemental cash flow information

	2005	2004
Interest paid	\$ 1,333,468	\$ 843,547
Income taxes paid	\$ 263,547	\$ 1,033,132
Components of change in non-cash working capital balances		
Accounts receivable	\$(16,879,203)	\$ (4,091,371)
Inventory	(161,366)	(109,970)
Prepaid expenses and deposits	2,781,509	(3,004,459)
Accounts payable and accrued liabilities	2,865,770	4,164,464
Income taxes payable	(734,411)	(435,011)
	(12,127,701)	(3,476,347)
Change in non-cash working capital on investing activities	(2,633,559)	4,275,931
Net change in non-cash working capital	\$(14,761,260)	\$ 799,584

18. Subsequent events

- (a) In February 2006, the Corporation issued 3,125,000 common shares by way of initial public offering for gross proceeds of \$50,000,000. Issue costs were approximately \$3,975,000. The net proceeds from the initial public offering were initially used to repay \$20.6 million drawn on the Corporation's extendable revolving facility with the balance of the net proceeds remaining in cash.
- (b) From January 1, 2006 to March 6, 2006, the Corporation granted 41,000 options at exercise prices ranging from \$20.75 to \$21.75, and 10,000 options at an exercise price of \$9.00 were cancelled.

